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Section 1.707-7 Disguised Sales of Partnership Interests. [Reserved]

Section 1.707-8 Disclosure of Certain Information

- (a) In general.
- (b) Method of providing disclosure.
- (c) Disclosure by certain partnerships.

Section 1.707-9 Effective Dates and Transitional Rules

- (a) Sections 1.707-3 through 1.707-6.
 - (1) In general.
 - (2) Transfers occurring on or before April 24, 1991.
 - (3) Effective date of section 73 of the Tax Reform Act of 1984.
- (b) Section 1.707-8 disclosure of certain information.

[T.D. 8439, 57 FR 44978, Sept. 30, 1992]

§ 1.707-1 Transactions between partner and partnership.

(a) *Partner not acting in capacity as partner.* A partner who engages in a transaction with a partnership other than in his capacity as a partner shall be treated as if he were not a member of the partnership with respect to such transaction. Such transactions include, for example, loans of money or property by the partnership to the partner or by the partner to the partnership, the sale of property by the partner to the partnership, the purchase of property by the partner from the partnership, and the rendering of services by the partnership to the partner or by the partner to the partnership. Where a partner retains the ownership of property but allows the partnership to use such separately owned property for partnership purposes (for example, to obtain credit or to secure firm creditors by guaranty, pledge, or other agreement) the transaction is treated as one between a partnership and a partner not acting in his capacity as a partner. However, transfers of money or property by a partner to a partnership as contributions, or transfers of money or property by a partnership to a partner as distributions, are not transactions included within the provisions of this section. In all cases, the substance of the transaction will govern rather than its form. See paragraph(c)(3) of § 1.731-1.

(b) *Certain sales or exchanges of property with respect to controlled partnerships—(1) Losses disallowed.* (i) No de-

duction shall be allowed for a loss on a sale or exchange of property (other than an interest in the partnership, directly or indirectly, between a partnership and a partner who owns, directly or indirectly, more than 50 percent of the capital interest or profits interest in such partnership. A loss on a sale or exchange of property, directly or indirectly, between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interest or profits interest in each partnership shall not be allowed.

(ii) If a gain is realized upon the subsequent sale or exchange by a transferee of property with respect to which a loss was disallowed under the provisions of subdivision (i) of this subparagraph, section 267(d) (relating to amount of gain where loss previously disallowed) shall apply as though the loss were disallowed under section 267(a)(1).

(2) *Gains treated as ordinary income.* Any gain recognized upon the sale or exchange, directly or indirectly, of property which, in the hands of the transferee immediately after the transfer, is property other than a capital asset, as defined in section 1221, shall be ordinary income if the transaction is between a partnership and a partner who owns, directly or indirectly, more than 80 percent of the capital interest or profits interest in the partnership. This rule also applies where such a transaction is between partnerships in which the same persons own, directly or indirectly, more than 80 percent of the capital interest or profits interest in each partnership. The term *property other than a capital asset* includes (but is not limited to) trade accounts receivable, inventory, stock in trade, and depreciable or real property used in the trade or business.

(3) *Ownership of a capital or profits interest.* In determining the extent of the ownership by a partner, as defined in section 761(b), of his capital interest or profits interest in a partnership, the rules for constructive ownership of stock provided in section 267(c) (1), (2), (4), and (5) shall be applied for the purpose of section 707(b) and this paragraph. Under these rules, ownership of

a capital or profits interest in a partnership may be attributed to a person who is not a partner as defined in section 761(b) in order that another partner may be considered the constructive owner of such interest under section 267(c). However, section 707(b)(1)(A) does not apply to a constructive owner of a partnership interest since he is not a partner as defined in section 761(b). For example, where trust T is a partner in the partnership ABT, and AW, A's wife, is the sole beneficiary of the trust, the ownership of a capital and profits interest in the partnership by T will be attributed to AW only for the purpose of further attributing the ownership of such interest to A. See section 267(c) (1) and (5). If A, B, and T are equal partners, then A will be considered as owning more than 50 percent of the capital and profits interest in the partnership, and losses on transactions between him and the partnership will be disallowed by section 707(b)(1)(A). However, a loss sustained by AW on a sale or exchange of property with the partnership would not be disallowed by section 707, but will be disallowed to the extent provided in paragraph (b) of § 1.267(b)-1. See section 267 (a) and (b), and the regulations thereunder.

(c) *Guaranteed payments.* Payments made by a partnership to a partner for services or for the use of capital are considered as made to a person who is not a partner, to the extent such payments are determined without regard to the income of the partnership. However, a partner must include such payments as ordinary income for his taxable year within or with which ends the partnership taxable year in which the partnership deducted such payments as paid or accrued under its method of accounting. See section 706(a) and paragraph (a) of § 1.706-1. Guaranteed payments are considered as made to one who is not a member of the partnership only for the purposes of section 61(a) (relating to gross income) and section 162(a) (relating to trade or business expenses). For a guaranteed payment to be a partnership deduction, it must meet the same tests under section 162(a) as it would if the payment had been made to a person who is not a member of the partnership, and the rules of section 263 (relat-

ing to capital expenditures) must be taken into account. This rule does not affect the deductibility to the partnership of a payment described in section 736(a)(2) to a retiring partner or to a deceased partner's successor in interest. Guaranteed payments do not constitute an interest in partnership profits for purposes of sections 706(b)(3), 707(b), and 708(b). For the purposes of other provisions of the internal revenue laws, guaranteed payments are regarded as a partner's distributive share of ordinary income. Thus, a partner who receives guaranteed payments for a period during which he is absent from work because of personal injuries or sickness is not entitled to exclude such payments from his gross income under section 105(d). Similarly, a partner who receives guaranteed payments is not regarded as an employee of the partnership for the purposes of withholding of tax at source, deferred compensation plans, etc. The provisions of this paragraph may be illustrated by the following examples:

Example 1. Under the ABC partnership agreement, partner A is entitled to a fixed annual payment of \$10,000 for services, without regard to the income of the partnership. His distributive share is 10 percent. After deducting the guaranteed payment, the partnership has \$50,000 ordinary income. A must include \$15,000 as ordinary income for his taxable year within or with which the partnership taxable year ends (\$10,000 guaranteed payment plus \$5,000 distributive share).

Example 2. Partner C in the CD partnership is to receive 30 percent of partnership income as determined before taking into account any guaranteed payments, but not less than \$10,000. The income of the partnership is \$60,000, and C is entitled to \$18,000 (30 percent of \$60,000) as his distributive share. No part of this amount is a guaranteed payment. However, if the partnership had income of \$20,000 instead of \$60,000, \$6,000 (30 percent of \$20,000) would be partner C's distributive share, and the remaining \$4,000 payable to C would be a guaranteed payment.

Example 3. Partner X in the XY partnership is to receive a payment of \$10,000 for services, plus 30 percent of the taxable income or loss of the partnership. After deducting the payment of \$10,000 to partner X, the XY partnership has a loss of \$9,000. Of this amount, \$2,700 (30 percent of the loss) is X's distributive share of partnership loss and, subject to section 704(d), is to be taken into account by

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him in his return. In addition, he must report as ordinary income the guaranteed payment of \$10,000 made to him by the partnership.

Example 4. Assume the same facts as in example 3 of this paragraph, except that, instead of a \$9,000 loss, the partnership has \$30,000 in capital gains and no other items of income or deduction except the \$10,000 paid X as a guaranteed payment. Since the items of partnership income or loss must be segregated under section 702(a), the partnership has a \$10,000 ordinary loss and \$30,000 in capital gains. X's 30 percent distributive shares of these amounts are \$3,000 ordinary loss and \$9,000 capital gain. In addition, X has received a \$10,000 guaranteed payment which is ordinary income to him.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7891, 48 FR 20049, May 4, 1983]

§ 1.707-2 Disguised payments for services. [Reserved]

§ 1.707-3 Disguised sales of property to partnership; general rules.

(a) *Treatment of transfers as a sale*—(1) *In general.* Except as otherwise provided in this section, if a transfer of property by a partner to a partnership and one or more transfers of money or other consideration by the partnership to that partner are described in paragraph (b)(1) of this section, the transfers are treated as a sale of property, in whole or in part, to the partnership.

(2) *Definition and timing of sale.* For purposes of §§ 1.707-3 through 1.707-5, the use of the term sale (or any variation of that word) to refer to a transfer of property by a partner to a partnership and a transfer of consideration by a partnership to a partner means a sale or exchange of that property, in whole or in part, to the partnership by the partner acting in a capacity other than as a member of the partnership, rather than a contribution and distribution to which sections 721 and 731, respectively, apply. A transfer that is treated as a sale under paragraph (a)(1) this section is treated as a sale for all purposes of the Internal Revenue Code (*e.g.*, sections 453, 483, 1001, 1012, 1031 and 1274). The sale is considered to take place on the date that, under general principles of Federal tax law, the partnership is considered the owner of the property. If the transfer of money or other consideration from the part-

nership to the partner occurs after the transfer of property to the partnership; the partner and the partnership are treated as if, on the date of the sale, the partnership transferred to the partner an obligation to transfer to the partner money or other consideration.

(3) *Application of disguised sale rules.* If a person purports to transfer property to a partnership in a capacity as a partner, the rules of this section apply for purposes of determining whether the property was transferred in a disguised sale, even if it is determined after the application of the rules of this section that such person is not a partner. If after the application of the rules of this section to a purported transfer of property to a partnership, it is determined that no partnership exists because the property was actually sold, or it is otherwise determined that the contributed property is not owned by the partnership for tax purposes, the transferor of the property is treated as having sold the property to the person (or persons) that acquired ownership of the property for tax purposes.

(4) *Deemed terminations under section 708.* In applying the rules of this section, transfers resulting from a termination of a partnership under section 708(b)(1)(B) are disregarded.

(b) *Transfers treated as a sale*—(1) *In general.* A transfer of property (excluding money or an obligation to contribute money) by a partner to a partnership and a transfer of money or other consideration (including the assumption of or the taking subject to a liability) by the partnership to the partner constitute a sale of property, in whole or in part, by the partner to the partnership only if based on all the facts and circumstances—

(i) The transfer of money or other consideration would not have been made but for the transfer of property; and

(ii) In cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

(2) *Facts and circumstances.* The determination of whether a transfer of property by a partner to the partnership and a transfer of money or other consideration by the partnership to the